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C O N F I D E N T I A L SECTION 01 OF 03 COLOMBO 001957

SIPDIS

DEPT PLEASE PASS TO E, EB, SA/INS, SA/RA, USAID FOR
BERNADETTE BUNDY - ANE/SA, USTR FOR AUSTR WILLS; TREASURY
FOR ROY ADKINS; NSC FOR ELIZABETH MILLARD; COMMERCE FOR
ARIADNE BENAÏSSA

E.O. 12958: DECL: 11/12/13

TAGS: [ECON](#) [PGOV](#) [PREL](#) [CE](#) [ECONOMICS](#)

SUBJECT: Economic Consequences of the Sri Lankan Political
Crisis and Post Recommendations on Assistance Programs

REF: A)Colombo 1902 B) Colombo 1916 C) Colombo 1917 D)
Colombo 1918 E) Colombo 1926 F) Colombo 1927 G) Colombo
1930

1. (U) Classified by Ambassador Jeffrey J. Lunstead,
Reasons 1.5 b, d and e.

2. (C) Summary: The ongoing political spat has negatively
affected the Sri Lankan economy, though the long-term
repercussions, especially the loss of potential investment,
are unknowable at this juncture. The Colombo Stock
exchange has been volatile and GSL representatives claim
investors and tourists are staying away. Post recommends a
"business as usual" approach, particularly in the financial
and economic aid realms, to avoid potentially further
upsetting the economic recovery, to not create an overly
negative impression on the peace process and to keep from
taking sides in this domestic dispute. End summary

3. (U) Post has reported extensively on President
Kumaratunga's recent political moves in Refs A - G. While
initial international news coverage of the events featured
footage of Sri Lanka's quiescent civil war and prior
terrorist attacks, the mood on the ground was one of calm
confusion. There was little evidence of a problem, aside
from extra police at certain intersections and a small
cadre of military guards at two government locations.

Economic Indicators

4. (SBU) The Colombo Stock Exchange (CSE) reacted to the
President's moves and subsequent events in a fairly
predictable manner. For the first two days of the crisis,
while the PM was still in Washington, the market suffered
its two single worst daily performances ever(dropping 6
percent and 13 percent respectively). On the day of the
PM's return (marked by a vocal throng of party loyalists at
the airport and thousands of supporters lining the streets
of his motorcade route into Colombo), the market was up
considerably, posting its largest ever single day gain
(13.3 percent). While daily turnover of shares was high
for the first two days of the situation, recent turnover
has been down considerably. We expect the volatility to
continue as the PM and the President continue their spat
and until some arrangement brings a sense of calm to the
political dynamics.

5. (U) While the CSE has been turbulent and the GSL has
posited concerns about FDI (see below), it is interesting
to note that on the two most volatile days of the stock
market so far, foreign purchases outpaced foreign sales
almost 6 to 1. International bargain hunters appear to
have taken advantage of the situation to buy well known Sri
Lankan blue chips.

6. (U) The Central Bank released its latest monetary policy
review on November 11, noting mostly positive trends in the
economy. The review did not predict the impact of the
current political crisis, though the Governor of the
Central Bank expressed hope the country would "get back to
normalcy soon" in a statement to the press.

IFI Positions

7. (U) The IMF has announced that the conclusion of Article
IV consultations and the next tranche of the Poverty
Reduction and Growth Facility (PRGF) disbursement will be
delayed, as the suspension of parliament has delayed the
presentation of the budget. Both the World Bank and IMF
reps in Colombo have called on the various parties to
resolve their differences and work together for sake of the
peace process and the economy.

Foreign Investment

8. (U) Board of Investment Chairman Arjuna Mahendran has
publicly called for the PM and the President to reconcile

their differences, noting that the President's actions had a negative effect on foreign investment. He claims a few companies have delayed exploratory visits. He has yet to give concrete evidence of investment leaving the country.

19. (SBU) According to Roshanthi Dias in the BOI Promotions Office, there was an initial drop in inquiries following the President's initial actions, but new investors have started to come in. Four new agreements have been signed in the past week, though all are with domestic investors. We do not know of specific pending investment decisions which had the potential to come to Sri Lanka, but have been scrapped due to the uncertainty in the political situation.

Tourism Sector

10. (U) GSL officials have consistently cited 2000 tourist cancellations as the impact so far on the tourism sector. According to representatives in the travel industry, most cancellations are coming from East Asia. All European tour groups have come as planned since the crisis began. Cancellations are mainly by individual travelers or families. A contact at Jetwing Travels, one of Sri Lanka's largest travel/tour groups, told us that a survey of six of the largest tour companies has revealed approximately 1200 cancellations.

11. (U) Most tour promoters are concerned about the length of the crisis, as it has the potential to severely affect the busy winter tourist season. Most have contacted their overseas booking offices to reinforce the message that this is a political issue and that the situation is under control. One silver lining: overbooked hotels have been able to use the cancellations to manage their guest flow. A good test will come in two weeks when Britain's cricket team and its swarms of fans are scheduled to descend on Sri Lanka for a long-anticipated cricket tournament.

Comment

12. (C) The situation on the ground remains calm, with most business (outside of the political realm) proceeding as normal. US military training with GSL forces continues, and the Sri Lankan military is acting in a professional manner. USAID continues to move forward with its programs and the GSL continues to plan for the release of its new budget (once parliament reconvenes, probably on November 19). We continue to focus on visits and issues related to ongoing economic reform programs.

13. (C) The effects of the President's actions on the peace process should also be considered in an economic context. The international community has been vocal in support of the peace process throughout this ordeal. Continued progress on economic development is imperative to avoid sending the wrong signals. The peace process is at an important juncture made more fragile by the ongoing political feud. As the US moves forward with economic aid and financial cooperation decisions, post recommends proceeding with a "business as usual" approach. A negative reaction by the USG to ongoing programs could be seen as a lack of confidence in the government's ability to weather this tempest and continue with the peace process. This could potentially foster negative reactions by others, including US businesses and donors, in Sri Lanka. End

Comment
LUNSTEAD